

Institutional All Cap Strategy

1Q10

Market Review

When we wrote in our commentary on the first quarter of 2009 that we had never been more optimistic about future equity returns since assuming portfolio management responsibilities for the Strategy, we had no idea the markets would rebound as far and as quickly as they have. From the March 9, 2009 market bottom to the end of the first quarter, the S&P 500 Index has returned approximately 77%, a stunning turnaround. The question we are struggling to answer now is, "Where do we go from here?" While we obviously don't have a definitive answer, we will explain how we are navigating the current environment and positioning the Portfolio for the future in an effort to generate superior risk-adjusted returns.

A year ago, we were in the middle of the worst recession since the Great Depression, one that was greatly exacerbated by a serious housing and credit crisis.

Despite this, our optimism on stock prices at the time stemmed from a combination of incredibly cheap valuations, pervasive negative sentiment, and a coordinated global response by government authorities to address the crisis.

Today, the environment is quite different. The recession likely ended sometime during the middle of 2009 and the economy appears to be squarely on the path of recovery. Economic data, as well as market indicators and corporate profits, are steadily improving in most respects. Not surprisingly, the pendulum of market sentiment has swung to optimism, and valuations can now best be described as reasonable. There remain, however, some stubborn realities, like unemployment hovering close to 10%, high levels of leverage in the system, and mixed data on housing and jobs.

We are still finding attractively priced stocks to invest in, but not to the extent we were 12 months ago. We think if the economic recovery continues on its current path and the employment and housing picture improve, stocks should continue to do quite well. On the other hand, buoyant psychology and valuations that are no longer cheap leave the market vulnerable to a correction if the economic data wane, corporate profits disappoint, or if there is some unforeseen shock like war or a terrorist event.

Portfolio Highlights

On an absolute basis, for the first quarter the Strategy had positive returns in six of the eight economic sectors in which we invested (out of 10 sectors in total). The greatest returns came in the materials, consumer discretionary, industrials, health care and financials sectors, while the information technology (IT) and energy sectors had negative returns.

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Relative to the benchmark Russell 3000 Index, for the first quarter both overall stock selection and overall sector allocation detracted from performance, with stock selection accounting for the majority of the difference. In terms of sector allocation, the Strategy's weighting in the "unassigned" category hurt relative performance, but overweights to the financials and materials sectors and underweights to the utilities and telecommunications services sectors helped it. Stock selection in the financials, IT, energy, industrials, consumer discretionary and consumer staples sectors also hurt relative performance for the quarter.

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- BA in Government from Dartmouth College

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- 11 years of investment industry experience
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PORTFOLIO MANAGER COMMENTARY



Over the course of the first quarter, we made a number of adjustments and changes to the Strategy's portfolio. We established new positions in a number of stocks, including BP PLC (ADS) and Oceaneering International Inc. in the energy sector, Jarden Corp. and Ross Stores Inc. in the consumer discretionary sector, Och-Ziff Capital Management Group LLC in the financials sector, Onyx Pharmaceuticals Inc. in the health care sector, as well as Agnico-Eagle Mines Ltd., Newmont Mining Corp. and Monsanto Co. in the materials sector. We also closed a number of existing positions during the quarter, including our holdings of Palm Inc., Juniper Networks Inc. and Blackboard Inc., all in the IT sector, Celgene Corp. and Johnson & Johnson in the health care sector, Newfield Exploration Co. and Diamond Offshore Drilling Inc. in the energy sector.

The leading individual contributors to Strategy performance for the first quarter included our positions in Family Dollar Stores Inc. and Ross Stores Inc., both in the consumer discretionary sector, Shire PLC (ADS) in the health care sector, Shaw Group Inc. in industrials and Newmont Mining Corp. in materials. The bottom individual contributors to performance for the quarter included Palm Inc. and Blackboard Inc. in the IT sector, Petrohawk Energy Corp. and Weatherford International Ltd. in the energy sector, and Li Ning Co. Ltd. in the consumer discretionary sector. Also detracting from performance was a short position in the SPDR S&P Retail ETF, which had been paired against long positions in Jarden Corp. and Ross Stores Inc.

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Outlook

In this environment, we find it especially important to stick to our discipline of investing in high-quality companies that trade at attractive valuations, have strong fundamentals, and are managed by executives that deploy capital effectively. Since companies with these characteristics generally lagged during the sharp recovery over the last year, they look even more compelling today. In fact, it has been those companies we tend to avoid – those with poor balance sheets and low returns on equity – that rebounded the most off the bottom, and we think the market will eventually gravitate toward the higher-quality companies that we hold. In short, we feel very good about the companies we own in our Portfolio, and we have never been more confident that our approach is the right one.

As always, we greatly appreciate your support as we strive to help you reach your financial goals.

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